



TAX BULLETIN 04-2

Virginia Department of Taxation

April 23, 2004

IMPORTANT INFORMATION REGARDING **2003 VIRGINIA INCOME TAX RETURNS**

VIRGINIA INCOME TAX FIXED-DATE CONFORMITY ADVANCED TO DECEMBER 31, 2003

Under emergency legislation passed by the 2004 General Assembly and signed by Governor Warner, Virginia's fixed-date of conformity to the terms of the Internal Revenue Code has been advanced from December 31, 2002 to December 31, 2003. However, Virginia will continue to disallow any bonus depreciation allowed for certain assets under federal income taxation and any 5 year carry-back of net operating losses ("NOL") allowed for NOLs generated in either taxable year 2001 or 2002. This notice is intended to provide taxpayers with directions on how to reconcile this legislation on their 2003 Virginia income tax returns.

Effective for taxable years beginning on and after January 1, 2003, Virginia's fixed-date of conformity to the terms of the Internal Revenue Code is advanced from December 31, 2002 to December 31, 2003, with two exceptions. Virginia will continue to disallow any bonus depreciation allowed for certain assets under federal income taxation and any 5 year carry-back of net operating losses ("NOL") allowed for NOLs generated in either taxable year 2001 or 2002. However, Virginia will conform to all other previously enacted provisions under federal income tax law.

The fixed-date conformity adjustments that will be no longer required when filing a 2003 tax return are those related to Section 179 asset expensing for individuals, corporations and fiduciaries.

VIRGINIA INCOME TAX

Since 1972, Virginia has conformed to federal income tax law. Whenever federal income tax law was changed, the changes automatically affected Virginia income taxes, unless otherwise exempted. In 2003, a provision was enacted that fixed Virginia's conformity to Internal Revenue Code terminology to the Internal Revenue Code as it existed on December 31, 2002. Because of changes in federal law contained in the Jobs and Growth Tax Relief and Reconciliation Act of 2003 and the Military Family Tax Relief Act of 2003, some taxpayers would have had to make adjustments to their federal adjusted gross income or federal taxable income through the fixed-date conformity adjustments on the 2003 income tax return. This bulletin will instruct taxpayers about which fixed-date conformity adjustments are still necessary for their 2003 income tax returns, if applicable.

Most Virginia taxpayers will not be affected by this change because only a limited number of taxpayers would have been required to make the special, fixed-date conformity adjustments.

Special Instructions for Taxpayers

Taxpayers Who Have Not Yet Filed

Individuals

Individuals who have a special, fixed-date conformity adjustment for bonus depreciation are still required to make the corresponding adjustments that are located on Pages 14 and 15 of the instructions for Form 760. In addition, if the federal bonus depreciation has an effect on any other item included in federal adjusted gross income, an adjustment must still be made as either an addition on Line C of Page 14 of the instructions for Form 760 or as a subtraction on Line C of Page 15 of the instructions for Form 760. All individuals with a fixed-date conformity adjustment will still be required to complete the Fixed-Date Conformity worksheet on Page 9 of the Form 760 Instructions.

The fixed-date conformity provision that individuals should disregard is the provision that would have prohibited Virginia income taxpayers from enjoying the increased federal Section 179 asset expensing limits on their Virginia return. The increased Section 179 asset expensing will now be allowed to flow through to the Virginia individual income tax return as a result of the emergency legislation. Therefore, individuals who have not yet filed their income tax returns can disregard the special, fixed-date conformity additions relating to the Section 179 asset expensing located on Page 14 of the instructions for Form 760.

Also, individuals who have not yet filed their income tax returns should disregard the special, fixed-date conformity subtraction for a "**Depreciation Subtraction**

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Resulting from Section 179 Expensing Adjustment” located on Page 15 of the instructions for Form 760.

For individuals who must file either a Form 760PY Part-Year Resident Individual Income Tax Return or a Form 763 Nonresident Individual Income Tax Return, all of the changes explained above for individuals will apply. The corresponding fixed-date conformity instructions for part year residents are located on Pages 14 through 15 of the Form 760PY Instructions. The corresponding fixed-date conformity instructions for nonresidents are located on Pages 11 through 13 of the Form 763 Instructions.

Military Family Tax Relief Act of 2003

Individuals are not required to adjust for the provisions of the Military Family Tax Relief Act. Among the provisions of this Act are an exclusion of the gain from the sale of a principal residence, after May 6, 1997, by a member of the uniformed and foreign services, an above the line deduction of up to \$1,500 for overnight travel expenses of National Guard and reserve members when members are traveling more than 100 miles from home in connection with National Guard or reserve duties and an expansion of the income tax exclusion for military death benefits. The 2003 Virginia Individual Income Tax Return and Instructions do not require adjustments for this Act because this bill was enacted after the publication date of the instructions. Any taxpayer amending an individual income tax return because of the exclusion of the gain from the sale of a principal residence provision, please see the section Taxpayers Who Have Already Filed, Page 5 of this bulletin, for instructions on filing an amended return.

Corporations

Corporations that have not yet filed their income tax returns should only make special, fixed-date conformity adjustments relating to the bonus depreciation. Adjustments relating to the bonus depreciation are entered on Lines 2 and 4 of Form 500 and explained on Page 4 of the Form 500 and 500S instructions. In addition, if the federal bonus depreciation has an effect on any other item included in federal taxable income, an adjustment is still required to be made as either an addition on Line 2b of Form 500 or as a subtraction on Line 4b of Form 500.

For Form 500S, adjustments relating to the bonus depreciation are described on Pages 7-8 of the Form 500 & 500S instructions. The adjustments relating to bonus depreciation are entered on lines 2a, 2c, 5a, and 5b of Form 500S. In addition, if the federal bonus depreciation has an effect on any other item included in federal taxable income, an adjustment is still required to be made as either an addition on line 2d or as a subtraction on line 5d of Form 500S.

The fixed-date conformity provision that corporations should disregard is the provision that would have prohibited Virginia corporate taxpayers from enjoying the increased federal Section 179 asset expensing limits on their Virginia return. The

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increased Section 179 asset expensing will now be allowed to flow through to the Virginia corporate income tax return as a result of the emergency legislation. Therefore, corporations who have not yet filed their income tax returns can disregard the special, fixed-date conformity additions related to the Section 179 asset expensing located on Page 4 of the instructions for Form 500. In addition, corporations who have not yet filed their income tax returns can disregard the special, fixed-date conformity subtractions related to the Section 179 asset expensing located on Page 4 of the instructions for Form 500.

Fiduciaries

Fiduciaries who have a special, fixed-date conformity adjustment for bonus depreciation are still required to make the corresponding adjustments that are located on Page 8 of the instructions for Form 770. In addition, if the federal bonus depreciation has an effect on any other item included in federal taxable income, an adjustment is still required to be made as either an addition on Line 3 of Page 9 of the instructions for Form 770 or as a subtraction on line 8 of Page 9 of the instructions for Form 770.

The fixed-date conformity provision that individuals should disregard is the provision that would have prohibited Virginia income taxpayers from enjoying the increased federal Section 179 asset expensing limits on their Virginia return. The increased Section 179 asset expensing will now be allowed to flow through to the Virginia fiduciary income tax returns as a result of the emergency legislation. Therefore, fiduciaries that have not yet filed their income tax returns can disregard the special, fixed-date conformity additions related to Section 179 asset expensing located on Page 9 of the instructions for Form 770. In addition, fiduciaries that have not yet filed their income tax returns can disregard the special, fixed-date conformity subtractions related to Section 179 asset expensing located on Page 9 of the instructions for Form 770.

Treatment of the 5-Year Net Operating Loss Carryback

The treatment of any 5-year net operating loss carryback is not affected by the passage of the 2004 legislation. All taxpayers should follow the instructions given in Virginia Tax Bulletin 03-1 regarding any necessary adjustment for a 5-year net operating loss carryback.

Taxpayers Who Have Already Filed

Individuals

Individuals who have already filed a 2003 individual income tax return with a fixed-date conformity adjustment that is not now required should file an amended 2003 Virginia individual income tax return. Amended individual income tax returns are filed using the 2003 Form 760 by filling in the oval at the top of Page 1 to indicate that the return is an amended return. Taxpayers should fill out the form completely and disregard those fixed-date conformity additions and subtractions explained above. Also, any taxpayer filing an amended return should follow the special instructions for amended returns on Page 21 of the Form 760 Instructions.

For nonresidents, instructions for filing an amended return are found on Page 18 of the Form 763 Instructions. Instructions for part-year residents filing an amended return are found on Page 22 of the Form 760PY Instructions.

For federal income tax purposes, taxpayers who wish to exclude the gain from the sale of a principal residence, after May 6, 1997, but prior to the 2001 taxable year, as allowed under the Military Family Tax Relief Act, have until November 10, 2004, to amend their returns for this purpose. For Virginia tax purposes, under *Va. Code* § 58.1-1823, taxpayers who wish to exclude the gain from the sale of a principal residence, after May 6, 1997, but prior to the 2001 taxable year, have one year from the filing date of their amended federal return to file an amended Virginia individual income tax return. Taxpayers who wish to exclude the gain from the sale of a principal residence for the 2001 or 2002 taxable years, have three years from the original due date of the Virginia individual income tax return to file an amended return. Forms for filing an amended return for the year in which an amendment is necessary are available on the Virginia Department of Taxation's website. Taxpayers filing an amended Virginia income tax return must include a copy of their amended federal income tax return with the amended Virginia individual income tax return.

Corporations

Corporations that have already filed a 2003 corporation income tax return with a fixed-date conformity adjustment that is not now required should file an amended 2003 Virginia corporation income tax return.

For Form 500 filers, amended returns are filed using Form 500X, the Amended Virginia Corporation Income Tax Return. Corporate income taxpayers should follow the instructions for Form 500X and recompute the proper fixed-date conformity adjustment, if any, and report the corrected amount as a change in Net Virginia Modifications on Line 2, Column B.

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For Form 500S filers, amended returns are filed using the Form 500S by checking the amended return box located at the top of Page 1 to the left of the name and address section. Taxpayers should fill out the form completely as if it were the original return and recompute the proper fixed-date conformity adjustments explained above.

Fiduciaries

Fiduciaries that have already filed a 2003 individual income tax return with a fixed-date conformity adjustment that is not now required should file an amended 2003 Virginia fiduciary income tax return. Amended fiduciary income tax returns are filed using the 2003 Form 770 by checking the amended return box located at the top of Page 1 above the Office Use Only box. Taxpayers should fill out the form completely as if it were the original return and recomputed the proper fixed-date conformity adjustments. Also, any taxpayer filing an amended return should follow the special instructions for amended returns on Page 3 of the Form 770 Instructions.

Health Savings Accounts for 2004

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was enacted in December 2003. As this bill is effective beginning in the 2004 taxable year, no adjustment would have been required for 2003 income taxes. The primary purpose of this Act was to reform the federal Medicare system. Most notably this bill created Health Savings Accounts, HSAs. HSAs are an expanded version of Archer Medical Savings Accounts. This bill provides a deduction for employers and an itemized deduction for individuals, beginning in 2004, for the amount paid during a taxable year by or on behalf of an individual to a health savings account. This provision would be effective for taxable years beginning after December 31, 2003. These deductions will be allowed to flow through to Virginia income tax returns because of the advancement of the date of conformity.

If you have any additional questions, please contact us at (804) 367-8031 for individual income tax questions or (804) 367-8037 for corporate income tax questions, or visit our website at <http://www.tax.state.va.us>.